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Special bulletin no. 13 (1922, July); Newspaper subscriptions; Depreciation on insulation in cold storage warehouses; Balance-sheets; Capital stock; Jewelry; Cocoanut oil industry; Depreciation on school buildings

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SPECIAL BULLETIN No. 13

July, 1922

[The Committee on Administration of Endowment authorizes the publication of special Bulletins, of which this is one, on the distinct understanding that members are not to consider answers given to questions as being official pronouncements of the Institute, but merely the individual opinions of accountants to whom the questions were referred. It is earnestly requested that members criticise freely and constructively the answers given in this or any other Bulletin of this series.]

NEWSPAPER SUBSCRIPTIONS

Q. In auditing the accounts of a daily and weekly newspaper publication, we find that all money received from subscriptions has been credited to income in the period in which received, and we also find that the method of keeping the records makes it very difficult to arrive at the amount of prepaid circulation at any date.

In this particular case the amount of prepaid circulation is important, and it is also important to know the amount of earnings in the future on the accrual basis. We should be glad to have you obtain through the Bureau of Information opinions as to the proper and practicable method of handling income from subscriptions on the accrual basis, and give us your results.

A. We suggest that the installation of a subscription record somewhat of the following columnar arrangement may answer the purpose:

1—Date
2—Number (or other identification) of subscription
3—Subscription period
4—Amount of subscription
Fiscal period to be credited
5— 1st quarter
6— 2nd quarter
7— 3rd quarter
8— 4th quarter
Beyond
9— Period
10— Amount
11—Remarks

All subscriptions should be entered consecutively and the amount spread over the fiscal periods in which they will be earned. Cancelations should be entered in similar manner but in red. At the close of each fiscal period the totals of columns 5, 6, 7, 8 and 10 should be respectively credited to the corresponding revenue accounts, a revenue account to be opened for each fiscal period. Among the earnings of the current fiscal period, say the first quarter of the year, only the balance of that particular revenue account should be taken up and the aggregate of balances of the other revenue accounts will appear on the liability side of the balance-sheet as a deferred item of "unearned subscriptions."

If monthly statements of earnings are required there should be a division of the subscriptions by months. If only an annual statement is desired the division of the subscriptions will be as between current and future years. Corresponding changes should then be made in the columnar arrangement of the above suggested record. The columns "beyond" will give the proportions applicable to the earnings of future years as well as the data for opening the subscription record and the several revenue accounts of the succeeding year.

DEPRECIATION ON INSULATION IN COLD STORAGE WAREHOUSES

Q. We should greatly appreciate it if you could advise the standard rate of depreciation on the insulation in cold storage warehouses.

A. The factors which determine the useful life of the insulation are quality of material and workmanship, the life of the equipment which is insulated and the conditions under which the business is operated.

The manufacturers of insulating material for cold storage warehouses agree that whether it be made of a cork, sawdust or straw base, if the material is properly made and applied, other conditions being ideal, the insulation material will last as long as the section of the building or the equipment to which it is applied. Disregarding the conditions under which the particular industry operates, the same rates of depreciation should be used for the insulation therefor as are used for the building, the flooring, the ceiling, the brine pipes, the tank or the refrigerating machinery, respectively.

The insulation material will deteriorate very rapidly if the building or the floor is subjected to shocks or jars, by reason of leaking pipes and other like causes. When these factors can be definitely computed the rates of depreciation first suggested should be adjusted thereby. For leaking pipes, unusual strains, etc., the adjustment must be determined from the experience of the particular enterprise or the necessary replacement be treated as a current expense.

BALANCE-SHEETS

Q. The company under consideration was organized in 1919 under the laws of the state of New York and was authorized to issue common stock of no par value to the aggregate of $500,000 at a minimum value per share of $5, which was the then existing law in this state in regard to capital stock of no par value. The first shares issued were to the president and a director of the corporation for goodwill and services for part of the first year. These shares were placed on the books at the minimum value of $5 per share. All other shares since that time have been issued for cash or property at the rate of $100 per share. The amount of stock issued to the president, which was given a value of $5 per share, enabled him to have the controlling interest in the outstanding capital stock. In the preparation of the balance-sheet we shall of course show the number of shares of stock outstanding and the aggregate value of the total shares. It will be obvious then that the value per share will be much less than $100 on account of the original issue to the president and a director on the basis of $5 per share. Our question is as to whether or not a specific footnote to the balance-sheet calling attention to the manner in which the stock was issued is necessary and also as to whether a succinct statement of the facts should be made as a definite part of the comments of the report.

We feel a duty towards stockholders and the public in preparing this report and we wish to be very technically correct in our presentation of the facts. Any opinion that you may care to procure for us in regard to the matter will be very greatly appreciated.

A. We are of the opinion the case submitted warrants a specific reference in the balance-sheet or as a footnote thereon as to the basis on which the two lots of the common capital stock of no par value have been issued. It might be contended that the stockholders who contributed property and cash on the basis of $100 per share should have had knowledge of the number of shares outstanding and the balance-sheet valuation of these shares immediately prior to their transactions, thereby recognizing that, as a result of their transactions, the value per share would really be less than $100. In the average body of shareholders, there would undoubtedly be a number who would not be sufficiently alert as to observe the effect of the transactions so far as the resulting value per share is concerned. On that account, it would seem to be well to clearly state the position. But what makes it more necessary is the wide variation in value per share between those originally issued for goodwill and services and those subsequently issued for property and cash, the fact that the shares issued at $5 per share were acquired by the president and a director and that the shares thus issued to the president gave him a controlling interest. While the statement in the balance-sheet would be sufficient, if it goes so far as to indicate the number of shares issued at $5 and the number at $100, with the values set against each, the reference necessary in the report should be made more extended.

CAPITAL STOCK

Q. It has always been my custom to make opening entries in the order of incidence of the physical conditions. Thus in the case of no par stock it seems necessary to make the entry for authorization of capital before the value of such capital has been determined. I submit the following set of entries which I am submitting for your criticism:

Opening Entries
THE BLANK COMPANY
Incorporated 1921

———, ———

February 25, 1921

Capital stock—common—unissued	2,500 shares	
Capital stock—common—authorized		2,500 shares
To record the authorization for issue of 2,500 shares of the common capital stock of the company without par. This is a statistical entry only for purpose of chronological record and fiscal entries will be made as shares are issued and values thereof determined from considerations received therefor.		
25		
Capital stock—preferred—unissued	100,000.00	
Capital stock—preferred—authorized		100,000.00
To record the authorization for issue of 1,000 shares of the preferred capital stock of the company at a par value of $100 each. See stock certificates and minute book for preference regulations.		

March 2, 1921		
Subscribers—common stock	50 shares 500.00	
Capital stock—common—unissued		50 shares 500.00
To record receipt of subscriptions for 50 shares of common stock at $10 each. The total value thereof ($500) is declared as the amount with which the company will "begin to carry on business."		
2		
Capital stock—common—unissued	500.00	
Capital stock—common—authorized		500.00
To record value established for fifty shares of common stock subscribed for in preceding entry.		
April 11, 1921		
Cash	500.00	
Subscribers—common stock		500.00
To record receipt of cash for stock subscribed for as noted in entry 3-2-21.		
11		
Stock in the Blank Company of 1907	47,610.78	
Cash		500.00
Stockholders in the Blank Company of 1907		47,110.78
To record purchase of stock in the Blank Company organized in 1907. See minutes of even date.		
11		
Stockholders in the Blank Company of 1907	2,450 shares 47,100.78	
Capital stock—common—unissued		2,450 shares 47,110.78
To record satisfaction of obligation to old stockholders by the issuance of 2,450 shares of common stock at the entered total value.		
11		
Capital stock—common—unissued	47,110.78	
Capital stock—common—authorized		47,110.78
To record value established for 2,450 shares of common stock issued as per preceding entry.		
April 11, 1921		
Cash in bank	1,086.39	
Petty cash	89.75	
Liberty bonds	3,450.00	
Inventory	3,182.46	
Office equipment	3,093.42	
Accounts receivable	4,078.48	
Wilberite Roofing Co.	3,408.61	
Cleveland Top & Specialty Co.	204.19	
Albert G. Wade	226.79	
Bulletins—March, April, May	68.70	
Special account—customers' dollar account	28.00	
Freight claims	847.42	
Customers' and prospects' list	120,000.00	
Customers' advances		3,100.16
Freight claims—customers		98.67
Notes payable		14,763.83
Trade acceptance		5,000.00
Accounts payable		6,117.98

Cray Bros.		54,636.87
C. J. Krehbiel		7,652.51
Credit vouchers of 1920		178.96
Credit vouchers of 1921		36.48
Reserve for depreciation		567.97
Stock in Blank Company of 1907		47,610.78
To record receipt of assets and assumption of liabilities of the Blank Co. of 1907, and cancelation of stock therein.		
28		
Treasury stock—common	300 shares	
Donated stock—common		300 shares
To record donation to company of three hundred common shares by G. A. Bottger and E. D. Cray.		
July 23, 1921		
Notes payable	2,000.00	
Capital stock—preferred—unissued		2,000.00
Issuance of 20 shares to Wm. Whitman in payment on a note held by Excelsior Ptg. Co.		
Excelsior Ptg. Co.	3,700.00	
Capital stock—preferred—unissued		3,700.00
Donated common stock	15 shares	
Treasury stock		15 shares
Above stock as indicated issued in payment of $3,700.		
Cray Bros.	54,500.00	
Capital stock—preferred—unissued		54,500.00
Above preferred stock issued as indicated in payment on account to Cray Brothers.		

A. In our opinion the entries covering unissued capital stock are not only unnecessary, but also burden the ledger with offsetting debit and credit items, which are of no value in the financial records, and also make the recording of the transactions covering the issue of capital stock unnecessarily complicated.

The journal should be opened with the entry recording the subscriptions to capital stock, this entry being preceded by an explanatory statement setting forth the name of the company and giving a brief summary of the articles of incorporation, including the purpose of the business, amount of capital stock authorized, etc. The credits to capital stock should only be for the stock actually subscribed for, it being of course very necessary that the records should show wherever any stock subscribed for remains unpaid. It might be well for the purpose of ready reference to make a note under the head of the capital stock account in the ledger as to the amount of authorized stock. This method will eliminate the first two entries, the second from the last on page 1, and the third on page 2, the word "unissued" being omitted from the other entries recording the subscriptions and issue of certificates.

We are not quite clear as to what is meant by the explanation given in the fifth entry "to record value established." If the company has been incorporated under the laws of the State of New York, we presume that the proper provision has been made in the articles of incorporation for the minimum value of the common stock in accordance with paragraph 3, section 19 of chapter 694, laws of 1921. If so, the amounts shown in this entry represent the asset value received in consideration of the issue of the stock, the value received from the original subscribers being at an entirely different rate from that received for the rest of the stock issued.

So long as the value received for the common stock is equal to, or exceeds the value stated in the articles of incorporation, no explanation is necessary further than a memorandum that issue was in accordance with the resolution of the board of directors.

As regards the entry recording the donation of stock to the company, we are of the opinion that the proportionate part of the book value of this common stock should be recorded in this entry and upon the sale of any of this stock, the proper proportion should be transferred from the donated stock account to capital surplus to record the value of the gift to the company.

If the fifteen shares of common stock were issued as a bonus with the preferred stock, it should be so stated in the entry, the value of the fifteen shares of common stock being treated as an additional cost of liquidating the account referred to.

A. It would appear to us that no good purpose can be served by spreading so many entries upon the books where a much less number would present an equally clear and certainly less confusing record. The principal criticism we have to make with reference to opening a "capital stock-common-unissued" account, as proposed in the inquiry, is the fact that in the entries suggested, the account has been debited and credited in some cases with shares only and other instances with dollars only, and in still others with both shares and dollars. After posting the entries and closing out the account its appearance, to say the least, would be unusual. Where no-par value stock is involved in books of account it is, of course, necessary to keep a sort of dual record, the one element recording the number of shares involved in the entries and the other the value in dollars placed upon the shares. This can best be accomplished by establishing a computing column for the number of shares in the explanatory column of the ledger account or accounts affected by the transactions in the shares.

In our opinion the recording of authorized shares of capital stock of no-par value can best be accomplished by appropriately heading the account "common stock authorized." Then, in the case mentioned, this account would be credited with 50 shares (recorded in the computing column for shares) and $500 (recorded in the regular money column), charging the subscribers with the $500. Similarly, another entry would be made crediting the former account with 2,450 shares and $47,110.78, charging "old company stock" therewith. This procedure would eliminate several unnecessary entries and produce a record which could be readily understood. Furthermore, we believe that giving effect in a subscriber's account to anything but dollars and cents is an erroneous practice. Under the plan outlined in the problem, subscriber's account is charged with 50 shares and $500, but on the other hand this account is credited only with $500, leaving in effect a debit balance of 50 shares in the account, which, obviously, is improper.

Another point that might be subject to criticism is the fact that the treasury stock which is offset by donated common stock is only entered as to the number of shares involved, while there was a definite value established per share by the issuance of 2,500 shares for $47,610.78. We believe that the value per share, thus established, should be used with respect to recording the donated stock.

JEWELRY

Q. I am desirous of obtaining the following statistical information relative to the manufacturing jewelry business to prove certain facts to a client and if you have such figures at your command or can refer me where to secure them would appreciate it greatly.

What is the general average of percentage for materials used, miscellaneous factory expenses, factory labor, selling expenses, overhead expenses, basing the figures on the sales?

A. We have no statistical information exactly in line with your inquiry but the following may be of interest:

A concern which manufactures silver toilet articles, tea services, vases, picture frames and other articles of a like nature, shows the following results for the fiscal year ended in 1921:

Labor, material and factory overhead	70.6
Selling expenses	3.9
Administrative and general	22.7

Another concern manufacturing a cheap line of jewelry shows the following results:

Labor, material and factory overhead	67.7
Selling expenses	22.4
Administrative and general	22.1

Still another concern, manufacturing jewelry novelties, etc., the raw materials of gold, silver, copper and brass, shows

Factory cost	68.9
Selling expenses	4.1
Administrative and general	5.2

Our records in none of the above cases show the separation as between labor, materials, and general factory overhead. In our opinion the percentage of labor and materials would vary considerably depending upon the nature of the product and the kind of raw material used. In some instances the finer materials, such as platinum and gold, might be used almost exclusively in connection with precious stones, whereas in other cases a large percentage of the product might be manufactured from cheaper materials and imitation stones.

COCOANUT OIL INDUSTRY

Q. What is the average rate of depreciation for steel and concrete buildings and machinery in the cocoanut oil industry?

A. Buildings—steel and concrete ....1—1½%

Machinery .... 10 %

DEPRECIATION ON SCHOOL BUILDINGS

Q. I am very anxious to obtain the best thought on the question of annual depreciation on school buildings and other fixed assets of school districts or municipalities.

In the great majority of cases these buildings are erected from the proceeds of bond issues voted especially for this purpose, and the authorities seem to differ regarding the method of handling depreciation.

It is obvious, of course, that annual provision must be made for a sinking fund to retire the bonds at the date of maturity.

Some authorities advance the idea that while depreciation should be taken into consideration as a part of the cost of operation, the charges should not be made against current revenue but should be applied against capital surplus. It appears to me that if it is to be considered as an operating expense, it should be charged against current revenue.

A. The difference among the authorities regarding the method of handling depreciation, to which your correspondent refers, is doubtless closely related to the difference of opinion as to whether capital assets and liabilities with a balancing capital surplus should or should not form part of a municipal balance-sheet. The arguments against their inclusion are presented in Oakey's "Principles of Government Accounting and Reporting." Without going into the technical counter arguments, we may suggest the practical one that the inclusion of these capital items presents in a concise form information regarding the property which the city has accumulated, and the extent to which it exceeds the outstanding funded debt—and thus, information which is unlikely to be elsewhere assembled in convenient form and sometimes quite unavailable.

School property and other fixed assets and the debt created to defray their cost of construction both enter into the capital portion of the balance-sheet, the net balancing figure of which is the capital surplus. Any adjustment of the value of the school properties must, therefore, affect to a corresponding extent the capital surplus. Depreciation in the value of the school properties goes to decrease this capital surplus.

It is desirable that the values at which city properties are carried not only should be reasonable but also should be computed according to a definable and defensible rule. Annual reduction of the asset or annual accretion to a depreciation reserve by a fair estimate of the accruing depreciation would accord with such a rule. Such provisions for depreciation are, on the argument indicated above, chargeable to capital surplus.

In municipal accounting, the provisions for sinking fund and for depreciation have no necessary relationship beyond the fact that a bond issue is sometimes limited by law to a term fixed by taking into consideration the normal term of service of an improvement of the character of that to be financed. While depreciation is a capital fund matter, sinking fund provisions must be made out of current revenues. The sinking fund itself is usually treated as a reserve fund, though in many instances it might reasonably be consolidated with the capital fund. To the extent that the provision for depreciation corresponds to the contribution raised for the sinking fund, the depreciation might be said to have been in effect provided out of current revenues.

In considering this matter we have had in mind property such as schools or other structures used for general city purposes. The principles applying to municipal utilities, such as water works, are fundamentally the same, but their application is somewhat different from that described.